

The Airport Complied With Solicitation Procedures for Concession Leases but Can Better Track Small and Local Business Participation

Airport Commission



July 18, 2019

City & County of San Francisco
Office of the Controller
City Services Auditor

About the Audits Division

The City Services Auditor (CSA) was created in the Office of the Controller through an amendment to the Charter of the City and County of San Francisco (City) that was approved by voters in November 2003. Within CSA, the Audits Division ensures the City's financial integrity and promotes efficient, effective, and accountable government by:

- Conducting performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of service delivery and business processes.
- Investigating reports received through its whistleblower hotline of fraud, waste, and abuse of city resources.
- Providing actionable recommendations to city leaders to promote and enhance accountability and improve the overall performance and efficiency of city government.

Team:

Nicole Kelley, Lead Audit Manager
Winnie Woo, Senior Auditor

Consultant:

Sjoberg Evashenk Consulting, Inc.

For more information please contact:

Tonia Lediju, PhD
Chief Audit Executive
Office of the Controller
City and County of San Francisco
(415) 554-5393



<http://www.sfcontroller.org>



[@sfcontroller](https://twitter.com/sfcontroller)



<https://www.linkedin.com/company/sfaudits/>

Audit Authority

CSA conducted this audit under the authority of the San Francisco Charter, Section 3.105 and Appendix F, which requires that CSA conduct periodic, comprehensive financial and performance audits of city departments, services, and activities.

Statement of Auditing Standards

This performance audit was conducted in accordance with generally accepted government auditing standards. These standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. CSA believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.



OFFICE OF THE CONTROLLER
CITY AND COUNTY OF SAN FRANCISCO

Ben Rosenfield
Controller
Todd Rydstrom
Deputy Controller

July 18, 2019

San Francisco Airport Commission
San Francisco International Airport
P.O. Box 8097
San Francisco, CA 94128-8097

Mr. Ivar Satero, Airport Director
San Francisco International Airport
P.O. Box 8097
San Francisco, CA 94128-8097

Dear Commission President, Commissioners, and Mr. Satero:

The Office of the Controller (Controller), City Services Auditor (CSA), presents its audit report of the competitive solicitation process the Airport Commission (Airport) uses to select tenants for food and beverage and retail concession leases at San Francisco International Airport (SFO). The audit had as its objectives to determine whether the Airport's solicitation process complied with the procurement policies and procedures of the City and County of San Francisco (City) and whether the Airport granted concession leases in accordance with its policies.

The audit concluded that the Airport properly administered the solicitation process in accordance with city policy and procedures and granted concession leases in accordance with departmental policies for food and beverage and retail concession leases. However, the Airport can better track small and local business participation data in concession leasing processes by continuing recently implemented efforts.

The report includes six recommendations for the Airport to improve tracking of small and local business participation data and to clarify existing leasing policies to improve transparency. The Airport's response is attached. CSA will work with the department to follow up every six months on the status of the open recommendations made in this report.

CSA appreciates the assistance and cooperation of all staff involved in this audit. For questions about the report, please contact me at tonia.lediju@sfgov.org or 415-554-5393 or CSA at 415-554-7469.

Respectfully,

A handwritten signature in black ink, appearing to read "Tonia Lediju".

Tonia Lediju, PhD
Chief Audit Executive

cc: Board of Supervisors
Budget Analyst
Civil Grand Jury
Citizens Audit Review Board
City Attorney
Mayor
Public Library

City and County of San Francisco

Office of the Controller – City Services Auditor

Airport Commission:

San Francisco International Airport Complied With Solicitation Procedures for Concession Leases but Can Better Track Small and Local Business Participation

June 2019



455 Capitol Mall • Suite 700 • Sacramento, California • 95814 • Tel 916.443.1300 •
www.secteam.com

Table of Contents

Table of Contents	i
Report Highlights	1
Audit Authority	2
Background	2
Scope and Methodology	2
Findings and Recommendations	4
Finding 1. The Airport complied with internal and city policies, procedures, and law for concession leasing solicitations	4
Finding 2. Although the Airport set goals to increase participation of small and local businesses in its concession leasing, local businesses' share of concession leases, locations, and gross sales declined slightly in the last decade.....	5
Finding 3. The Airport complied with required policies to extend concession leases, but must develop written policies on use of the holdover lease provision	10
Finding 4. Efforts to limit the number of concession leases may not promote operator diversity as intended	12
APPENDIX: Department Response	14

PURPOSE

Sjoberg Evashenk Consulting, Inc. (SEC) was engaged by the City and County of San Francisco (City) City Services Auditor (CSA) to audit the competitive solicitation process for food and beverage and retail concession leases at San Francisco International Airport (SFO). The objective of the audit was to determine whether the solicitation process complies with the City's procurement policies and procedures and whether concession leases are granted in accordance with Airport Commission policies.

KEY RESULTS

The Airport's competitive solicitation process for food and beverage and retail concession leasing complies with internal policies, Airport Commission policy, and the San Francisco Administrative Code. The audit determined that the Airport's Revenue Development and Management unit (RDM) adhered to its own guidelines for developing a request for proposal (RFP), ensured that staff met key milestones described in each RFP, confirmed that proposers sufficiently met minimum qualifications, ensured proposal evaluation panelists had experience and expertise relevant to the RFP, and ensured scores were accurately reported to the Airport Commission for determining lease awards.

Further, the Airport demonstrated its desire to increase small and local business participation in the concession leasing process by establishing airport-wide strategic initiatives, goals, and objectives and implementing programs to encourage local participation. However, the audit found that the non-local business share of concession leases, concession locations, and gross sales between 2008 and 2018 increased while the local business share of these indicators decreased slightly. Contributing factors may include perceived barriers to participation related to financial requirements, the federal restrictions on granting preferential points in the concession solicitation process, and the significant expense associated with concession operations at a large international airport. Also, the Airport can better track small and local business participation in its concession leasing processes by continuing recently implement efforts.

The audit also found that the Airport complied with its policies to extend concession leases and to limit the number of leases concession operators may hold. However, the Airport lacks a formal policy on when lease holdovers may be used.

KEY RECOMMENDATIONS

The audit report offers six recommendations, including these key recommendations:

- Adopt a formal departmental policy that defines small and local businesses, including specific geographic areas, and identify businesses that participate in all aspects of the Airport's concession leasing processes that meet the definitions.
- Continue recent efforts to track and measure small business and local business participation and outcomes in concession leasing against established goals and develop metrics to measure the success of programs and efforts aimed at increasing participation. Regularly report progress to the Airport Commission.
- Develop policies and procedures on the usage of holdover provisions in concessions leases, detailing when it is appropriate to exercise the option, the term of holdover, and approval requirements.

AUDIT AUTHORITY

This audit was conducted under the authority of the Charter of the City and County of San Francisco (City), Section 3.105 and Appendix F, which requires the City Services Auditor (CSA) to conduct periodic, comprehensive financial and performance audits of city departments, services and activities. In addition, the Airport requested this audit to ensure that its solicitation process complies with departmental and City policies and laws. CSA engaged Sjoberg Evashenk Consulting, Inc., (SEC) to conduct the audit.

BACKGROUND

The Airport Commission (Airport) oversees and makes policy for San Francisco International Airport (SFO).¹ The Airport is an enterprise department of the City.² The Airport director manages SFO's day-to-day operations. As a section of the Business and Finance division, the Revenue Development and Management unit (RDM) manages the use and leasing activities of concessionaires and related businesses on SFO property and is the primary contact with concession tenants. RDM develops, implements, and administers proposals for use, bid packages, leases, permits, and other documents related to concession property rental.

San Francisco Administrative Code Section 2A.173 requires that concessionaires at SFO be selected through a competitive solicitation and selection process. According to the Airport, its standard practice is to issue requests for proposal (RFPs) to select tenants for retail and food and beverage concessions. The Airport has an established concession program to continually seek new concessions to maximize goods and services available to passengers. SFO's concessions provide patrons with food, beverage and retail offerings, as well as passenger services such as rental cars, banking, and luggage carts.

SCOPE AND METHODOLOGY

The objective of the audit was to determine whether the Airport's competitive solicitation process for its food and beverage and retail concession leasing complies with the City's procurement policies and procedures and whether the Airport grants concession leases in accordance with departmental policies. Specifically, the audit determined whether the Airport's competitive solicitation process:

- Complies with City policies, procedures, and requirements.
- Adheres to the competitive solicitation process as published in its RFPs.
- Provides for the appropriate level of transparency.

¹ This report uses "the Airport" to mean the city department, not just the Airport Commission itself.

² Enterprise departments operate business-type activities and are self-supporting, in whole or part, such that their customer service charges and operating revenues cover the costs associated with providing their respective functions. At the City & County of San Francisco, the Airport, the Port, the Public Utilities Commission, the Municipal Transportation Agency, San Francisco General Hospital, and Laguna Honda Hospital are all referred to as enterprise departments.

- Provides fairness and a level playing field for all proposers.
- Ensures lease extensions and holdover provisions are appropriately justified.
- Complies with Airport Commission policies limiting the number of leases per owner.
- Has increased the number of individual food and beverage business owners since the Airport ended the master operator approach to leasing.

The audit reviewed food and beverage and retail concession leasing activity in 2008 and 2018 and competitive solicitations conducted in 2015 through 2017. The audit did not assess the appropriateness of the criteria or requirements in the competitive leasing solicitations, including the minimum qualifications that proposers must meet.

To meet the audit's objectives, SEC performed the following audit steps:

- Interviewed key Airport management and staff involved in conducting and overseeing the competitive solicitation process; reviewed applicable policies, procedures, codes and regulations related to developing and conducting the competitive solicitation process.
- Reviewed the Airport's goals and objectives related to concession leasing and analyzed concession leasing statistics in 2008 and 2018 to determine if local business participation increased.
- Identified potential barriers to small and local business participation in the competitive solicitation process; reviewed the universe of formal complaints regarding the competitive solicitation process submitted since 2008.
- Compared applicable policies, procedures, codes and regulations to established Airport competitive solicitation process guidelines, to processes published in RFPs, and to staff activities and proposer documentation.
- Reviewed proposal evaluation panelists' qualifications, the panelist selection process and validated proposal scores submitted by panelists.
- Analyzed RFP proposer diversity and RFP award diversity, outreach activities to potential proposers, and the Airport's use and average duration of lease extensions.
- Distributed a survey to prior RFP participants and interested parties to gather feedback on the Airport's competitive solicitation process.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on the audit objectives. We believe that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

FINDINGS AND RECOMMENDATIONS

Finding 1. The Airport complied with internal and city policies, procedures, and law for concession leasing solicitations.

The Airport properly administered the solicitation process in accordance with internal policies, Airport Commission policy, and San Francisco Administrative Code for the food and beverage and retail concession leasing RFPs issued between 2015 and 2017. For the five RFPs analyzed (out of 21), detailed in Exhibit 1, the Airport maintained adequate documentation to demonstrate that it complied with internal and city solicitation procedures. Specifically, the audit found that Revenue Development and Management (RDM) adhered to internal guidelines for developing an RFP, ensured that RDM staff met key milestones described in each RFP, confirmed that proposers sufficiently met minimum qualifications prior to advancing in the solicitation process, ensured proposal evaluation panelists had experience and expertise relevant to the RFP and properly submitted panelists scores to the Airport Commission for determining lease award.

Exhibit 1: RFPs Selected for Review

Description of RFP	Number of Leases Included in RFP	Lease Award Date
Terminal 3 Specialty Retail Stores	1	April 7, 2015
Terminal 3 Retail Marketplace	1	October 4, 2016
Terminal 3 Boarding Area F & Terminal 1 Boarding Area C Food and Beverage	8 (reviewed lease #1)	December 6, 2016
International Terminal Newsstand & Specialty Retail	5 (reviewed lease #5)	September 5, 2017
International Terminal A Coffee	1	October 17, 2017

Furthermore, we conducted a survey of individuals and businesses listed on the Airport's master list of parties interested in RFPs concerning leases at SFO and found that more than 90 percent of survey respondents indicated that the Airport's competitive solicitation processes for concession leases were appropriately administered. For example, respondents overwhelmingly indicated that information conferences provided clear information regarding solicitation requirements and fully addressed their questions.

Finding 2. Although the Airport set goals to increase participation of small and local businesses in its concession leasing, local businesses' share of concession leases, locations, and gross sales declined slightly in the last decade.

In addition to evaluating whether the Airport's competitive solicitation processes for concession leasing were consistent with City procedures and requirements, the audit was also tasked with determining if the processes ensured fairness and a level playing field for all participants. As described in Finding 1, the Airport complied with the City's policies, procedures, and requirements, however, fully assessing a level playing field requires the consideration of benefits derived from the processes, including the distribution of awards by type of participant. As such, the audit analyzed the distribution of concession leases and locations held by local and non-local businesses, the amount of gross sales generated by concession operators, and efforts by the Airport to identify and address potential disparities in participation rates.

The audit found that the Airport demonstrated its desire to increase small and local business participation in the concession leasing process through establishing airport-wide strategic initiatives, goals, and objectives and implementing efforts to encourage local participation, including establishing a Pop-Up retail program and promoting joint ventures and partnerships. However, the Airport had not consistently tracked and measured its progress toward meeting participation goals. Even with the focused attention to increase participation, the audit found that non-local business share of concession leases, concession locations, and gross sales increased over the last ten years while local business share decreased. Contributing factors may include perceived barriers to participation related to financial requirements, the federal government's restrictions on granting preferential points, and the significant expense often associated with concession operations at a large international airport.

The Airport Did Not Consistently Track Small Business Participation Until Late 2016, Limiting the Audit Analysis to Only Local Business Participation

The Airport's 2017-2021 five-year strategic plan describes objectives to achieve increased small and local business participation, specifically an airport wide goal of 40 percent for small business and a 40 percent goal of local San Francisco themes and concepts or local business participation specific to concession leasing. The Airport's Small Business and Workforce Services Office (SBWS), which promotes local and small business participation in concession leases and contracts, has recently developed definitions to classify businesses at SFO as local or small, as appropriate, and has instituted strategies to track components of their participation in the concession leasing process. The definitions include a mix of location and business size criteria:

- San Francisco Local Business Enterprise (LBE)—local businesses with a primary place of business in San Francisco as certified by the City's Contract Monitoring Division.
- San Francisco Small Business—small businesses that have a local, state, or federal small business designation and have a registered office/business license in San Francisco.
- Local Small Business—small businesses that have a local, state, or federal small business designation and have a registered office/business license in the nine Bay Area counties.

- Small Business—small businesses that have a local, state, or federal small business designation.
- Airport Concession Disadvantaged Business Enterprise (ACDBE)—small businesses certified by the California United Certification Program.

The audit found that the Airport did not consistently track data necessary to fully assess its small business participation in active concession leasing to assess the Airport's progress toward participation goals—SBWS only recently begun tracking participation data, starting with leases awarded in late 2016. The Airport recently issued a solicitation for a business diversity tracking system and indicated that it is close to finalizing a vendor.

Because sufficient information was not available to analyze small business participation in concession leasing processes, the analysis in Finding 2 largely focuses on local business participation. The City generally defines San Francisco local businesses as businesses located within San Francisco's 47 square miles. However, according to the Airport, SFO not only serves San Francisco residents and visitors but residents of and visitors to all of the nine Bay Area counties. For the purpose of this audit local business is defined as those with a primary business address within nine Bay Area Counties: Alameda, Contra Costa, Marin, Napa, San Francisco, San Mateo, Santa Clara, Solano, and Sonoma. This definition of local business considers businesses within 101 cities across 7,000 square miles. Non-local businesses would be considered any business located outside of the nine Bay Area counties.

The following analysis includes a comparison of businesses with active food and beverage and retail concession leases in 2008 and 2018³.

The Airport Met Its Goal of Local Business Participation for Concession Leases and Locations but the Local Business Share Decreased as Concession Leases and Locations Increased

While the Airport does not track data to measure progress toward meeting its small business participation goals in concession leasing, the audit found that the Airport met its goal related to local business participation with 59 percent of concession leases and 42 percent of concession locations held and operated by Bay Area businesses in 2018.

However, the audit also found that as the number of leases and locations increased over the last decade, local business share of participation decreased. Specifically, as shown in Exhibits 2 and 3, leasing data indicates that the number of active concession leases and locations at SFO increased between 2008 and 2018: leases increased 10 percent, from 80 to 88, and locations increased 14.5 percent, from 144 to 165.

³ Active leases held by majority owners in January 2008 and April 2018.

Exhibit 2: Active Concession Leases in 2008 and 2018
Increase of Non-Local Business Participation

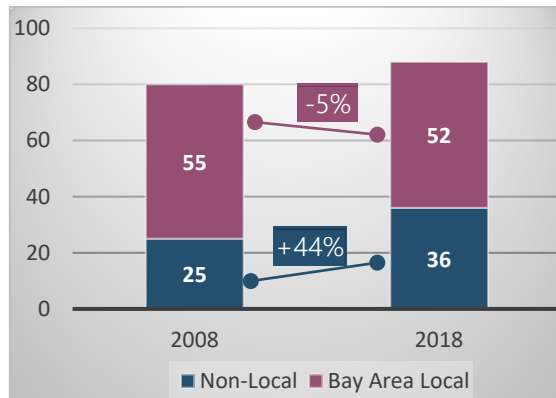
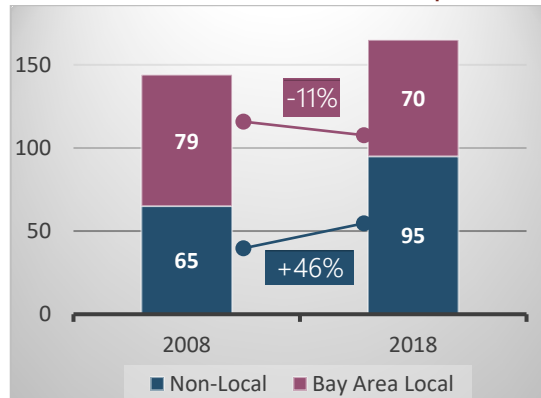


Exhibit 3: Concession Locations in 2008 and 2018
Increase in Non-Local Business Participation



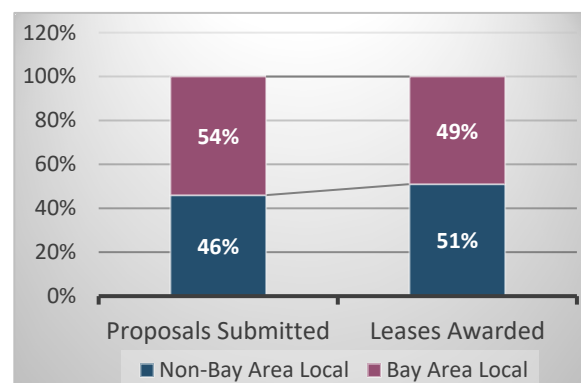
As concession leasing activity at SFO increased between 2008 and 2018, non-local businesses increased their percentage share of leases by 44 percent and the local businesses decreased its share of leases by 5 percent, as shown in Exhibit 2. Similarly, non-local businesses increased their percentage share of locations by 46 percent and local businesses decreased its share of locations by 11 percent, as shown in Exhibit 3.

Further, non-local businesses also had increases in gross sales generated by concession operations. Specifically, Bay Area local businesses with active leases in 2008 held 69 percent of concession leases and 55 percent of leased locations while generating 59 percent of the corresponding total gross concession sales, including sales attributed to local businesses with local joint venture partnerships and sub-lease arrangements with non-local leaseholders. A decade later in 2018, Bay Area local businesses held a smaller percentage share of concession leases and locations than in 2008 (59 percent and 42 percent, respectively) and their percentage share of total gross concession sales fell by 10 percent to 49 percent while non-local business percentage share of concession sales increased by 10 percent.

Participants Perceive Financial Requirements and Restrictions on Providing Local Preferential Points as Barriers to Concession Leasing Opportunities

During the audit, we were informed of perceived barriers to participation related to financial requirements and the federal government's restrictions on granting preferential points to local businesses. Our review of RFP responses for concession leases awarded between 2015 and 2017 found that non-San Francisco local businesses submitted the vast majority of the responses to the concession RFPs when compared to San Francisco businesses and, correspondingly, won most of the leasing

Exhibit 4: 2015 -2017 RFP Proposals Submitted and Leases Awarded



opportunities in each of the three years. However, we noted that including Bay Area RFP proposals in the local proposals totals revealed that Bay Area local business proposals and lease awards were about the same as non-local businesses, as shown in Exhibit 4.

Financial Barriers May Hinder Local Business Participation

Concession leases require proposers to agree to standard requirements to be considered for the concession opportunity, including paying at least the Minimum Annual Guarantee (MAG) as rent, committing a minimum investment, and demonstrating past achievement of minimum sales volume. The Airport established these requirements to ensure concession operators can successfully provide the required services.

According to the Airport the reason why San Francisco's local businesses are underrepresented in the concession proposals submitted to the Airport may relate to the perception that the financial requirements in the Airport's RFPs hinder participation. Responses to the survey of individuals and businesses listed on the Airport's master list of parties interested in Airport RFPs also indicate that the financial requirements may discourage some parties from submitting proposals for concession leases. Specifically, 37 percent of respondents believe the financial requirements are challenging, including the initial investment, MAG, and minimum sales requirements. A review of the MAGs of active leaseholders in 2008 and 2018 found that the average MAG increased significantly over the last decade—from \$658,500 in 2008 to \$807,600 in 2018, an increase of \$149,100 (23 percent). In response to concerns raised by potential proposers regarding MAGs, the Airport has, at times, adjusted MAGs downward. For example, in 2016, the MAG for RFP Terminal 3 Marketplace Retail Lease #16-0256 was reduced from \$1,500,000 to \$1,350,000 annually. However, even with the reduction in MAG, the award winner was a non-local business located outside of the Bay Area.

According to the Airport, it is expensive for businesses to operate at an international airport, so national businesses often have an advantage because they can more easily handle the large capital expenditure and staffing demands that some concession leasing opportunities require. For example, tenant build-out costs can be \$800 to \$1,100 per square foot or higher, depending on the store's footprint. Also, concessionaires at SFO are required to be open 16 hours a day, 365 days a week, and pay the minimum hourly wage dictated by the City's Minimum Compensation Ordinance, which has historically been, on average, \$1.86 higher than the minimum wage in the City's Minimum Wage Ordinance. Further, all employees working at SFO must pass Transportation Security Administration (TSA) background checks that often take several weeks, increasing staffing costs.

Restrictions on Offering Preferential Points in the RFP Process May Discourage Local Business Participation

In addition to the perception of financial barriers, some Airport staff and survey respondents commented that the lack of local business preference points in the Airport's concession solicitation processes may also discourage these businesses from participating in the process. However, the Airport is not allowed to grant preferences to any local business for concession leasing due to federal restrictions preventing assigning preference points to local businesses in concession lease solicitations based on location. Specifically, Parts 23 and 26 of the Code of Federal Regulations (CFR) 49 requires the Airport to comply with the Airport

Concession Disadvantaged Business Enterprises (ACDBE) regulations, which prohibit the Airport from administering preferences, quotas, and set-asides based on geographical area or based on race and gender. However, according to the Airport, although it cannot provide preference points to local businesses, there are outreach efforts to encourage the participation of both small and local businesses, including access to concessions seminars offered by the SBWS.

Although federal regulations prevent the Airport from providing preferential assistance to local businesses during concession leasing solicitations, neither federal rules nor Chapter 14B of San Francisco's Administrative Code prevent the Airport from providing assistance to small businesses, such as providing preferential points as incentive to participation. According to the Airport, providing a small business preference has been considered by the airport over the years, and some recent opportunities have been released as small business set-asides. While the Airport cannot provide a local business preference due to federal restrictions, the Airport should consider the feasibility of establishing a robust small business participation preference program in the concession leasing competitive solicitation process.

The Airport Has Implemented Certain Efforts to Encourage Small and Local Business Participation

In 2014, RDM developed a five-year Pop-Up Retail Program for one-year concession lease opportunities directed specifically at small businesses that earn no more than \$2,000,000 in annual gross sales. The program is designed to provide greater access to concession lease opportunities and minimize the financial barriers to concession lease participation many local and small businesses face by reducing permit fees and lowering concession buildout costs. The Airport's ultimate goal with the program is to have participants leverage their "hands-on" experience of operating a small concession location under a one-year Pop-Up Retail Program concession lease and utilize it as a springboard to obtain larger, multiyear leases. Between 2015 and 2017, four concession solicitations were associated with the Pop-Up Retail Program, of which two were awarded to small businesses located in San Francisco and two were located in cities within the broader Bay Area. According to RDM management, the Pop-Up Retail Program assisted a recent program participant, RAKH Inc., in obtaining a retail concession lease at SFO by helping the business gain confidence that the initial capital investment concerns are outweighed by the ultimate sales revenue that can be achieved. In the spring of 2019, the Airport plans to request authorization from the Airport Commission to renew the program, with a few changes based on participant feedback, including extending the program lease term from one year to two years, or to make the program permanent.

Additionally, RDM and SBWS have incorporated a variety of programs and activities directed at promoting small and local business participation in concession lease opportunities. RDM and SBWS conducts on-going outreach to local community organizations, chambers of commerce, and businesses to disseminate information on the RFP process and upcoming concession opportunities. RDM also created a portal on the Airport's website where interested businesses may sign up to receive notices of upcoming business opportunities. Like RDM, the SBWS Office conducts outreach through a variety of events it conducts throughout the year, including workshops on access to capital and pathways to entry for small businesses and informational conferences on upcoming concession opportunities.

Further, over the last several years, SBWS has promoted joint ventures and partnerships between large concession companies and small, local businesses to provide smaller entities with additional opportunities for entry into concession operator leases at SFO. The purpose of joint partnerships is to provide local, small businesses with concession operations experience through a leveraged relationship with larger, established businesses to share the financial costs and risks. While SBWS only recently began tracking joint venture and partnership data, the Airport indicated that approximately 14 percent of current active leases are joint ventures where the primary leaseholder, typically a larger concessionaire, has partnered with a smaller and/or local business.

Recommendations

The Airport should:

1. Revisit goals established in the recent strategic plans and determine reasonable small and local business participation goals that can be achieved given the limitations within which the Airport must operate to comply with federal laws.
2. Adopt a formal policy that defines small and local businesses, including specific geographic areas, and identify businesses that participate in all aspects of the Airport's concession leasing processes (e.g., proposals, lease awards, etc.) that meet the definitions.
3. Continue recent efforts to track and measure small business and local business participation and outcomes in concession leasing against established goals and develop metrics to measure the success of programs and efforts aimed at increasing participation, including the Pop Up program, outreach, etc. Regularly report progress to the Airport Commission. Airport should consider using the City's financial system to record and track tenant diversity for lease contracts.
4. Continue to determine the feasibility of establishing small business participation preference in the concession leasing competitive solicitation process.

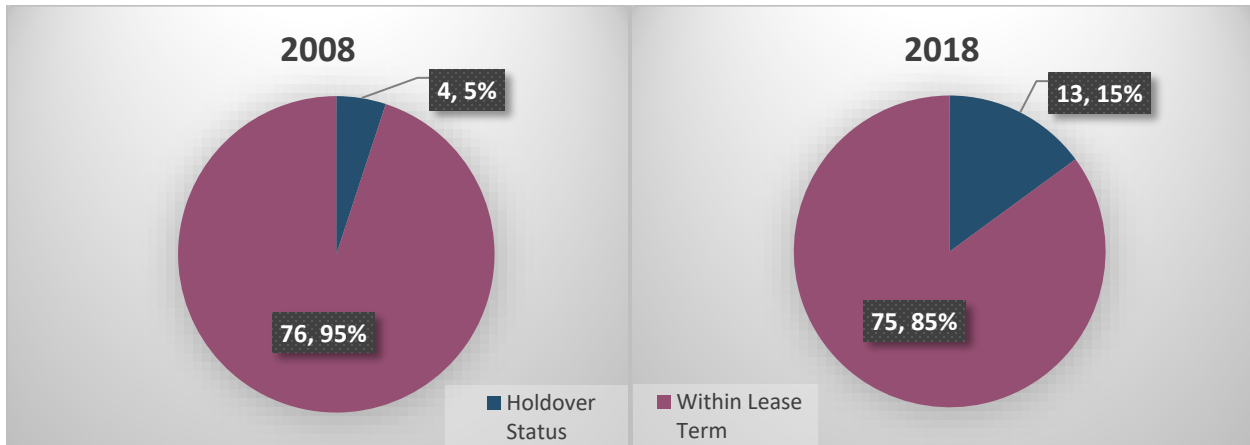
Finding 3. The Airport complied with required policies to extend concession leases, but must develop written policies on usage of the holdover lease provision.

Based on our review of lease agreements, the Airport appropriately exercised its options to lease extension in accordance with lease terms. As allowed by lease provisions, the Airport uses holdover provisions to extend leases, but the audit found that the Airport does not have a written policy to guide the use of the holdover arrangement for its concession lease agreements.

Retail and food and beverage concession lease agreements may include options periods provisions, generally one to five years to the original lease term. Concession leases expire once formal extension options have been exhausted and the lease must be put back out for competitive award. Also, concession lease agreements at SFO allow for expired leases to automatically continue via "holdover" provision (month-to-month tenancy) until a new lease is awarded.

To determine the frequency of the Airport's use of holdover option, the audit analyzed lease expiration data on active concession leases in 2008 and 2018 and found that use of holdover increased between 2008 and 2018. Specifically, 4 (5 percent) of 80 businesses operated under the holdover provision in 2008 and 13 (15 percent) of 88 businesses operated under the holdover provision in 2018, as shown in Exhibit 5.

Exhibit 5: Leaseholders Operating Under a Holdover Period



For most of the leases operating under the holdover provisions, Airport management stated the reason was to keep businesses operational, particularly related to construction as terminal construction activities do not always align with existing lease expiration dates. Although these explanations appear reasonable, Airport management could not identify the reason why one of the leases operated under the holdover provision in 2008 and indicated that it may have been an oversight.

The concession lease agreements do allow the Airport to continue leases on holdover status, but the Airport does not have guidelines or policies and procedures to ensure that lease holdovers are permitted for only appropriate and justifiable purposes, term duration, and only when approved by management at SFO or the Airport Commission itself. The lack of a formal policy may create a perception that expired concession leases are extended inappropriately via month-to-month arrangements when leasing opportunities should be made available to new qualified businesses through a competitive solicitation process. Further, because one of the Airport goals is to increase concession lease programs to increase small and local business participation, it is important that lease terms are justified and monitored to ensure opportunities are made available when possible, especially when non-local businesses have had longer lease terms than local leaseholders as discussed in the next section.

Recommendation

5. The Airport should develop policies and procedures on the usage of holdover provisions in the concessions leases, detailing when it is appropriate to exercise the option, term of holdover, and approval requirements to ensure lease holdovers are permitted for only appropriate and justifiable purposes.

Finding 4. Efforts to limit the number of concession leases may not promote operator diversity as intended.

Airport management indicated that it has been a priority to increase the number of unique food and beverage and retail business owners at SFO to avoid the consolidation of concession leases and locations by a small group of businesses and to encourage more ownership diversity. However, we found that the Airport's efforts to limit the number of concession leases per business owner may not promote operator diversity as desired.

The Airport Complies with Airport Commission's Lease Limit Policy, But Bundling Locations within Leases Decreases Opportunities for Operator Diversity

In 2010, the Airport Commission implemented a policy to limit the number of concession leases that any one individual or entity may hold at any one time; currently, the policy limits business owners to eight leases. The audit did not find any violation of the Airport Commission's policy where leaseholders had more than eight leases for the 2018 leaseholders.

However, we found that the Airport allows multiple concession locations and offerings within a single lease (bundling), such as one lease involving the operation of a variety of concession retail store locations. Specifically, we found that in 2018, there were 27 active leases that included multiple locations within a single lease—one leaseholder had 10 concession locations across three leases and a leaseholder for duty free concessions had 26 locations associated with a single lease, which appears to bypass the Airport Commission's desire to limit leases and increase concession operator diversity. According to the Airport, leases are only bundled "to make business deals work," such as pairing poor locations with high-performing locations.

Further, when reviewing concession solicitation activity trends across 15 RFPs over the last three years, which included 41 leases, we noted that one lease award for duty free retail included twelve locations. According to Airport management, federal regulations require duty-free concessionaires to maintain a bonded warehouse to store retail goods. Because SFO has limited warehouse space to comply with federal regulations, RDM bundled all duty-free retail locations within one lease for which a single bonded warehouse space on SFO premises is needed. According to the Airport, having one lease for duty-free operations is a frequent approach by international airports in the US.

Although the Airport complied with the Commission's lease limit policy and its justification for bundling appear reasonable for its business purpose, the Airport's practice of bundling locations decreases available lease locations, which results in decreased operator diversity opportunities. To meet the Airport's 40 percent goal of local San Francisco themes and concepts or local business participation specific to concession leasing, the Airport should consider exploring other airport's leasing methodologies to determine if the bundling practice is the most appropriate way lease locations while trying to promote diversity.

Insufficient Data Exists to Determine if Leasing Activities Over the Last Decade Increased Unique Operator Diversity

In the early 2000s, the Airport used a master lease agreement model with concession management companies to manage and oversee concession activities at SFO. Individual concession operators leased food and beverage and/or retail concession spaces from a master concession leaseholder instead of holding a lease directly with the Airport. According to the Airport, the master lease model was no longer used by 2004 for any concession leases in favor of maximizing local ownership and the number of individual owners. Additionally, the Airport believed the master leaseholder also held a significant number of the total available concession leases for themselves rather than subleasing these leases to multiple businesses. As such, the Airport began managing and overseeing concession activities, and started executing leases directly with concession businesses to limit consolidation of leases and increase leaseholder diversity.

Although we attempted to assess whether moving from the master tenant model to direct leasing successfully increased operator diversity as intended, we were unable to perform a comparative analysis because the Airport was unable to provide sufficient leasing data related to the time period when the master tenant model was fully employed. Although we were unable to determine whether the change of a new leasing approach successfully increased operator diversity, we noted that over the last ten years, the number of individual concession leaseholders did not significantly change. Specifically, of the 80 active food and beverage and retail leases in 2008, 52 (or 65 percent) were unique businesses, and in 2018, 56 (or 64 percent) individual businesses held the 88 active food and beverage and retail leases. However, according to the Airport, the operator diversity increased significantly in fiscal year 2004-05 when the model shifted from one master lease to many individual leases, but as mentioned earlier the Airport did not have the data for us to make the assessment.

Recommendation

6. The Airport should revisit the Airport Commission's policy limiting the number of leases and consider proposing policy changes that may include limitations on the number of locations that leaseholders may operate. This will help ensure the policy is aligned to promote the desired operator diversity to minimize the concentration of lease ownership among a limited number of operators and to promote operator diversity.

APPENDIX: DEPARTMENT RESPONSE



San Francisco International Airport

July 9, 2019

Tonia Lediju
Chief Audit Executive
City Services Auditor Division
Office of the Controller
City and County of San Francisco
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Subject: Airport Concession Leases Solicitation Process Audit

Dear Ms. Lediju:

Attached is the Airport's completed Audit Recommendation & Response Form regarding the audit follow-up of Airport Concession Leases Solicitation Process.

If you have any questions, please feel free to call us at (650) 821-2850 (Wallace) or (650) 821-4500 (Cheryl).

Very truly yours,


Wallace Tang, IAP, CPA, CGMA
Airport Controller


Cheryl Nashir
Director
Revenue Development & Management

cc: Ivar C. Satero
Jeff Littlefield
Leo Fermin
Emylene Aspillia
Ben Rossenfield – Controller's Office
Todd Rydstrom – Controller's Office
Mark dela Rosa – CSA
Winnie Woo – CSA

Attachment

AIRPORT COMMISSION CITY AND COUNTY OF SAN FRANCISCO
LONDON N. BREED MAYOR LARRY MAZZOLA PRESIDENT LINDA S. CRAYTON VICE PRESIDENT ELEANOR JOHNS RICHARD J. GUGGENHIME MALCOLM YEUNG IVAR C. SATERO AIRPORT DIRECTOR
Post Office Box 8097 San Francisco, California 94128 Tel 650.821.5000 Fax 650.821.5005 www.flysfo.com

RECOMMENDATIONS AND RESPONSES

For each recommendation, the responsible agency should indicate in the column labeled *Agency Response* whether it concurs, does not concur, or partially concurs and provide a brief explanation. If it concurs with the recommendation, it should indicate the expected implementation date and implementation plan. If the responsible agency does not concur or partially concurs, it should provide an explanation and an alternate plan of action to address the identified issue.

Recommendation	Agency Response	CSA Use Only Status Determination*
The Airport should:		
1. Revisit goals established in the recent strategic plans and determine reasonable small and local business participation goals that can be achieved given the limitations within which the Airport must operate to comply with federal laws.	<input checked="" type="checkbox"/> Concur <input type="checkbox"/> Do Not Concur <input type="checkbox"/> Partially Concur Airport staff will analyze its experience re-leasing the bulk of the concessions program over the last three years and the current composition of concessions' tenant ownership. A report will be prepared by year's end for the Airport Commission which either validates the current small and local business participation goals or informs the Airport Commission of modifications to those goals.	<input checked="" type="checkbox"/> Open <input type="checkbox"/> Closed <input type="checkbox"/> Contested
2. Adopt a formal policy that defines small and local businesses, including specific geographic areas, and identify businesses that participate in all aspects of the Airport's concession leasing processes (e.g., proposals, lease awards, etc.) that meet the definitions.	<input type="checkbox"/> Concur <input type="checkbox"/> Do Not Concur <input checked="" type="checkbox"/> Partially Concur Airport staff will inform the Airport Commission of the small and local business definitions established by federal, state, and local government entities and their applicability to Airport contracting. Airport staff will formalize its definition of "local" versus small business as it relates to describing participation in all aspects of concession leasing processes.	<input checked="" type="checkbox"/> Open <input type="checkbox"/> Closed <input type="checkbox"/> Contested

* Status Determination based on audit team's review of the agency's response and proposed corrective action.

Recommendation	Agency Response	CSA Use Only Status Determination*
<p>3. Continue recent efforts to track and measure small business and local business participation and outcomes in concession leasing against established goals and develop metrics to measure the success of programs and efforts aimed at increasing participation, including the Pop Up program, outreach, etc. Regularly report progress to the Airport Commission. Airport should consider using the City's financial system to record and track tenant diversity for lease contracts.</p>	<p><input checked="" type="checkbox"/> Concur <input type="checkbox"/> Do Not Concur <input type="checkbox"/> Partially Concur</p> <p>Airport staff will continue tracking and measuring small and local business participation in concessions leasing and share the results with the Airport Commission on a regular basis. The Airport will consider leveraging the City's financial system as it finalizes the implementation of business diversity software designed specifically for tracking compliance with 49 CFR Part 23 (ACDBE) and 49 CFR Part 26 (DBE).</p>	<p><input checked="" type="checkbox"/> Open <input type="checkbox"/> Closed <input type="checkbox"/> Contested</p>
<p>4. Continue to determine the feasibility of establishing small business participation preference in the concession leasing competitive solicitation process.</p>	<p><input checked="" type="checkbox"/> Concur <input type="checkbox"/> Do Not Concur <input type="checkbox"/> Partially Concur</p> <p>Airport staff will strive to include Small Business Set Aside opportunities in each redevelopment program.</p>	<p><input checked="" type="checkbox"/> Open <input type="checkbox"/> Closed <input type="checkbox"/> Contested</p>
<p>5. Develop policies and procedures on the usage of holdover provisions in the concessions leases, detailing when it is appropriate to exercise the option, term of holdover, and approval requirements to ensure lease holdovers are permitted for only appropriate and justifiable purposes.</p>	<p><input checked="" type="checkbox"/> Concur <input type="checkbox"/> Do Not Concur <input type="checkbox"/> Partially Concur</p> <p>Airport staff will formalize its holdover practice in a Standard Operating Procedure document written for use by Revenue Development & Management staff. Additionally, the Airport Commission will be updated in writing on the Airport's practice with holdovers.</p>	<p><input checked="" type="checkbox"/> Open <input type="checkbox"/> Closed <input type="checkbox"/> Contested</p>
<p>6. Revisit the Airport Commission's policy limiting the number of leases and consider proposing policy changes that may include limitations on the number of locations that leaseholders may operate. This will help ensure the policy is aligned to promote the desired operator diversity to minimize the concentration of lease ownership among a limited number of operators and to promote operator diversity.</p>	<p><input checked="" type="checkbox"/> Concur <input type="checkbox"/> Do Not Concur <input type="checkbox"/> Partially Concur</p> <p>Airport staff will analyze its experience re-leasing the bulk of the concessions program over the last three years and the current composition of concessions' tenant ownership. A report will be prepared by year's end for the Airport Commission which either validates the current policy limiting ownership in concessions leases or seeks approval for a modification to that policy.</p>	<p><input checked="" type="checkbox"/> Open <input type="checkbox"/> Closed <input type="checkbox"/> Contested</p>

* Status Determination based on audit team's review of the agency's response and proposed corrective action.